TEACHERS' RETIREMENT BOARD

REGULAR MEETING

SUBJECT: Update on Federal Legislation ITEM NUMBER: 5b

ATTACHMENT(S): 2

ACTION: X MEETING DATE: February 6, 2003

INFORMATION: ___ PRESENTER: Ed Derman

IMPLEMENTATION OF THE SARBANES-OXLEY CORPORATE GOVERNANCE AND ACCOUNTING REFORM LEGISLATION

CalSTRS' federal counsel has been providing staff with regular written updates on the implementation by the SEC of various major components of the Sarbanes-Oxley corporate governance and accounting reform legislation. Those updates are attached.

The Sarbanes-Oxley Act established the Public Company Accounting Oversight Board (PCOAB), as the new regulator of the accounting industry. Appointed to the board are

- Acting chair Charles Niemeier, former Chief Accountant of the SEC's Enforcement Division
- Kayla Gillan, former Chief Counsel of CalPERS
- Daniel Goelzer, former General Counsel to the SEC
- Former Congressman Willis Gradison, who also lobbied for the health insurance industry.

On January 9, at its first official meeting, PCOAB approved a first year budget of $36.6 million, and, with 11 staff already on board, has set about hiring senior staff positions with a target of 200 professionals by year-end 2003. Through the SEC, the Treasury will advance start-up funds to the PCOAB to be repaid from fees collected from securities issuers and registration fees from public accounting firms. By the end of 2003, the PCOAB has established the goal of inspecting the Big Four Accounting firms, and will also begin the review of other public accounting firms.

ELK HILLS COMPENSATION

FY 2003 Installment

Funding for the fifth $36 million installment for FY 2003 was included in both the House and the Senate Interior Appropriations measures, which were caught in the legislative gridlock that has forced the Federal Government to operate on an interim financing basis four months into the new fiscal year.

With the introduction of a new Congress and the direction from the President to cut $10 billion from the overall spending level agreed to in the last Congress, the Congressional appropriators have been forced to start over on these "carry over" FY 2003 spending measures. Because the House and Senate appropriators had "forward funded" the FY 2003 Elk Hills installment so that it does not become payable until the beginning of the following fiscal year (October 1, 2003), the FY 2003 installment of Elk Hills compensation does not count against the FY 2003 spending cap that the Congressional appropriators are now struggling to meet.

House and Senate Republican leadership have tried to accelerate the deliberation of these leftover FY 2003 spending measures in an effort to "clear the decks" of last year's matters before the President lays out his budget and program for the coming year in his State of the Union address on January 28. The GOP leadership adopted a "continuing resolution" keeping the Federal Government funded at FY 2002 levels and sending the measure over to the Senate to add the actual appropriations bills.

Final Payments

The Settlement Agreement between the State and the Federal Government calls for a payment in the range of $72 million in FY 2004. The final figure, however, remains subject to the final determination of the equity shares of the U.S. and Chevron in the Elk Hills field. This final determination remains unresolved some six years after the sale of Elk Hills. CalSTRS federal counsel will be coordinating with the State Attorney General regarding application of the provisions of the Settlement Agreement that address this possibility. In addition, securing appropriation of $72 million – twice the level of previous appropriations – in this difficult budget environment will be a daunting task.

PENSION SECURITY LEGISLATION

House Legislation

The House and the Senate are anticipated to move pension security legislation this year that is very similar to the legislation passed by the House last year, reported out by the Senate Finance Committee but stalled on the Senate Floor. The key features of last year's House pension security legislation, according to the official description,:

- Require investment education and a benefit statement,
- Require blackout notices,
- Explain fiduciary duty during a blackout period,
- Require that employee's be given the right to diversify once certain conditions are met; and
- Provide increased availability of investment advisors to assist plan participants in making good decisions about their investments.

Senate Legislation

Some of the components of last year's Finance Committee pension legislation concern:

- Divestiture of company stock after three years of service,
- Protection of workers during blackouts,
- Investment information provided to employees
- Taxation of executive compensation

More detailed information on areas of concern in the tax legislation is included in Hogan and Hartson's attached report.

SUMMARY OF FEDERAL LEGISLATION

Mr. Derman will provide a verbal update at the meeting.

MEMORANDUM FOR
THE CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM

Washington Monthly Report

Implementation of the Sarbanes-Oxley Corporate Governance and Accounting Reform Legislation

We have been providing STRS staff with regular written updates on the implementation by the SEC of various major components of the Sarbanes-Oxley corporate governance and accounting reform legislation.

Attached for your information is a status report on the implementation of the key provisions of the Sarbanes-Oxley legislation as of the close of 2002.

The new regulator established by the Sarbanes-Oxley legislation for the accounting industry, the Public Company Accounting Oversight Board (PCOAB), continues to organize in the wake of the appointment snafu that cost Securities and Exchange Commission Chairman Harvey Pitt and initial PCOAB Chairman William Webster their jobs. Joining Kayla Gillan, former Chief Counsel of CalPERS, are Charles Niemeier, former Chief Accountant of the SEC's Enforcement Division who is serving as acting Chairman, Daniel Goelzer, former General Counsel of the SEC, and Willis Gradison, a respected former Member of Congress who recently had a career as a lobbyist for the health insurance industry.

The new PCOAB has raised some eyebrows on Capitol Hill by voting to pay the Chairman an annual salary of $560,000 and the other Board members an annual salary of $452,000 – more than the President of the United States and more than three times the salary of a Member of Congress. Reform apparently can be a lucrative field, at least if one picks the right target.

At the PCOAB's first official meeting on January 9, it approved a first year budget of $36.6 million, and with 11 staff already on board has set about hiring for senior staff positions with a target of 200 professionals by year-end 2003. The senior staff of the PCOAB will consist of a Chief Administrative Officer, Chief Auditor, General Counsel, Director of Enforcement, and Director of Inspections and Registration. These senior staff members will earn $425,000 per year. Paul Schneider, a former chief financial officer for the Acacia Group insurance company, has been appointed as interim Chief Administrative Officer. The PCOAB also will have a Director of External Communications.

Treasury will advance start-up funds to the PCOAB through the SEC, to the PCOAB, to be repaid from fees collected from securities issuers and registration fees from public accounting firms.

The PCOAB has established the goal of inspecting the Big Four Accounting firms by the end of 2003, and also will begin review of other public accounting firms.

Elk Hills Compensation

STRS thus far has $144 million in Elk Hills compensation from the Federal Government.

Funding for the fifth $36 million installment for FY 2003 was included in both the House and the Senate Interior Appropriations measures that were caught up in the Congressional appropriations gridlock that has forced the Federal Government to operate on an interim financing basis four months into the new fiscal year.

With the advent of a new Congress and the direction from the President to cut $10 billion from the overall spending level agreed to in the last Congress, the Congressional appropriators have been forced to start over on these "carry over" FY 2003 spending measures. Because the House and Senate appropriators had "forward funded" the FY 2003 Elk Hills installment so that it does not become payable until the beginning of the following fiscal year (October 1, 2003), happily the FY 2003 installment of Elk Hills compensation does not count against the FY 2003 spending cap that the Congressional appropriators are now struggling to meet.

The House and Senate Republican Leadership have sought to expedite the consideration of these left over FY 2003 spending measures in an effort to "clear the decks" of last year's matters before the President lays out his budget and program for the coming year in his State of the Union address on January 28. To move things along and to save House GOP members from controversial votes on education and other spending cuts, the GOP Leadership settled on the rather exotic strategy of simply adopting a "continuing resolution" keeping the Federal Government funded at FY 2002 levels and sending the measure over to the Senate to add the actual appropriations bills. However, it could be slow going on the Senate Floor, where Democrats and some Republicans may be offering amendments to restore funds cuts to meet the President's demands.

We will be working to ensure that STRS's FY 2003 installment of $36 million is included in this omnibus spending package, as well as to begin laying the foundation for the next installment of compensation due for FY 2004.

For FY 2004, the Settlement Agreement between the State and the Federal Government calls for a payment in the range of $72 million. However, the final figure remains subject to the final determination of the equity shares of the U.S. and Chevron in the Elk Hills field. This final determination remains unresolved some six years after the sale of Elk Hills, a languorous pace even by Federal Government standards. We will be coordinating with the State Attorney General regarding application of the provisions of the Settlement Agreement that address this contingency. In addition, securing appropriation of $72 million – twice the level of previous appropriations – in this difficult budget environment will be a daunting task.

Pension Security Legislation

The House and the Senate are expected to move pension security legislation this year that is very similar to the legislation passed by the House last year and reported out by the Senate Finance Committee that became mired down on the Senate Floor.

Here is an outline of the key provisions from last year's House and Senate pension security bills that are expected to serve as the starting point for this year's legislation.

a. Key features of expected House pension security legislation

The key features of last year's House pension security legislation, according to the official description, are as follows:

Investment Education and Benefit Statement:

- The bill requires the plan administrator of a self-directed defined contribution plan to provide an annual notice to plan participants and beneficiaries of the value of investments allocated to their individual account, including their rights to diversify any assets held in employer securities. Defined benefit plans would have to provide a benefit statement at least one every 3 years to be a participant.

- The notice will also include an explanation of the importance of a diversified investment portfolio including a risk of holding substantial portions of a portfolio in any one security, such as employer securities.

- The Secretary of Treasury will issue guidance and model notices that include the value of investments, the rights of employees to diversify any employer securities and an explanation of the importance of a diversified investment portfolio. Initial guidance will be no later than January 1, [2004]. The Secretary may also issue interim model guidance.

- Notice may be electronic if reasonably accessible to the recipient.

Blackout Notices

- The House bill also includes a provision addressing the so-called "blackouts", usually done during changes in plan administrators, during which participant access to plan distributions is restricted. A provision addressing this issue already has been enacted as part of the Sarbanes-Oxley Act, and hence the "blackout' provision may be dropped from the final pension security legislation.

Inapplicability of Relief from Fiduciary Liability During Suspension of Ability of Participants to Direct Investments

- The bill explains fiduciary duty during blackout period. It clarifies that fiduciaries are not liable for losses provided that fiduciaries satisfy the requirements of this title.

- Relevant considerations in determining the satisfaction of fiduciary duty are also added, such as the provision of the blackout notice, the fiduciary's consideration of the reasonableness of the period of suspension, and the fiduciary's actions solely in the interest of participants and beneficiaries.

Diversification:

- The bill ensures that all employee contributions to pension plans will be immediately diversifiable.

- The bill provides for a five-year transition rule for the allowable diversification of employer securities held in individual account plans as of the date of enactment.

- The bill provides for the option of a rolling three-year diversification of employer securities. In this case employer securities may be diversified three years after the calendar quarter in which they were contributed.

- The bill in general exempts individual account plans that do not hold employer securities that are readily tradable on an established securities market.

Investment Advice:

- The bill includes the text of the Retirement Security Advice Act, which provides increased availability of investment advisors to assist plan participants in making good decisions about their retirement assets.

- Employees will also be able to use pre-tax dollars to obtain their own investment advice.

b. Key features of Senate pension security legislation

The Senate Finance Committee reported out its version of pension security legislation last year on a broad bipartisan basis. As described in the official Committee summary, the following are the key components of last year's Finance Committee pension legislation:

Diversification of Defined Contribution Plan Assets. A typical defined contribution pension plan may keep workers locked into company stock contributed by the employer indefinitely. Employee Stock Ownership Plans (ESOPs), which by definition are highly concentrated in employer stock, are the only plans currently subject to diversification requirements, and they are only required to allow workers to begin diversifying their holdings once they reach age 55 and have 10 years of participation in the plan. The bill generally provides that publicly held companies must allow workers to divest themselves of company stock once they have completed 3 years of service (with a 3 year phase-in for stock contributed in previous years). Only free-standing ESOPs are exempt from the requirement.

Protection of Workers during Blackouts. The Senate Finance Committee bill also includes a provision addressing so-called "blackouts" during which participant access to plan distributions is restricted. A provision addressing this issue already has been enacted as part of the Sarbanes-Oxley legislation, as hence the Finance Committee version may be dropped from the final Senate pension security legislation.

Providing Information to Assist Participants. Under current law, plan administrators are generally not required to provide benefit statements to workers except when the workers themselves request a statement, and then no more than once each year. There is also no requirement for pension investment guidelines and information to be provided. The bill requires quarterly benefit statements for defined contribution plans that allow workers to direct their own investments; annual statements for plans that do not allow worker investment

direction; and once every 3 years to workers in defined benefit plans. The bill also requires all workers to receive annual investment guidelines and information that would, at a minimum, include: information on the benefits of diversification of investments; the differences in risk and returns of various forms of investments; and information on investment allocations based on age and years to retirement.

Fiduciary Duty to Provide Material Information. The bill requires sponsors of defined contribution plans under a new ERISA provision to ensure that all material information the employer is required to disclose to investors under the securities laws also be provided to workers concerning investments in company stock in the worker's account. There is no comparable requirement in current law.

Electronic Disclosure of Insider Trading. The bill requires that companies sponsoring plans that allow workers to invest in employer stock disclose to plan participants any sale of stock by an officer, director, or affiliate or the employer that is required to be disclosed to the SEC. The information must be posted on the plan's website in a reasonably practicable timeframe after disclosure to the SEC.

Independent Investment Advice. Questions exist under current law concerning the extent of an employer's liability under ERISA for investment advice given to participants, and these questions have had a chilling effect on the willingness of many companies to make investment advice available through their pension plan to their workers. The bill establishes a checklist that, once successfully completed by the employer, relieves him/her of liability for any losses that result from the investment advice given. The items that must be verified by the employer include: that the investment advisor is qualified; that the advisor accepts full fiduciary liability for any advice given; that the advisor is independent (does not have financial conflicts with respect to the plan); that the advisor will take into account employer stock held by the worker when providing its advice; and that the advisor has the necessary insurance coverage for any claim by a participant or beneficiary.

Clarification of Access to Remedies. Recent court decisions have raised uncertainty about the extent to which plan participants may sue a fiduciary on their own behalf to recover losses to their pension plan accounts. The bill clarifies the individual's right to sue under ERISA.

Bonding of Fiduciaries. Under current law, fiduciaries are required under ERISA to post a bond equal to 10% of the funds they handle, but not to exceed $500,000. Fiduciary bonds are designed to cover losses stemming from fraud or dishonesty by plan officials, and the maximum bonding cap has not been raised since the mid-1970s. The bill increases the bond cap to $1 million for plans containing employer stock.

Optional Forms of Benefit Calculations. Under defined benefit plans, participants generally may choose among a variety of forms of benefits. Treasury is working on regulations specifying the types of information that must be made available to workers before they must make these decisions, but the regulations did not get completed in last year's business plan and it is uncertain when they'll be issued. In the meantime, plan participants are faced with making decisions about benefit options, sometimes without fully understanding the financial consequences of these decisions. This can be particularly true in cases where one or more of the options effectively eliminates a type of benefit, such as an early retirement incentive, and that fact is not made clear to the participant. The bill requires the Secretary of Treasury to complete its regulations within 30 days of the bill's enactment, and expresses the Committee's expectation that the regulations will ensure that participants are making informed decisions as to which form of benefit to elect, including early retirement benefits that are incorporated into the calculations.

Executive Compensation Provisions in Senate Pension Bill

The Senate Finance legislation also contains four proposals to ensure appropriate taxation of executive compensation, including certain bonuses, loans, and deferred compensation arrangements.

Enforce Deferred Compensation Rules. Since 1978, the Treasury Department has been limited in its ability to enforce laws that determine whether executive deferred compensation arrangements should be taxed currently or deferred until the funds are distributed. The legislation would remove a 1978 moratorium on new regulations and permit Treasury to better define deferred compensation arrangements that merit deferral of taxation and those that should be taxed currently.

Prohibit Deferral on Compensation Parked in Offshore Trusts. In order for a trust to qualify as nontaxable deferred compensation, the monies in the trust must be subject to the claims of general creditors. Placement of funds in offshore trusts can be used to thwart attempts by U.S. bankruptcy courts to access these compensation arrangements. The legislation generally provides that funds in an offshore trust will be deemed not to be subject to the claims of creditors, and generally the funds will be taxed. An exception would be provided for situations where the employee for whom the trust is established provides personal services in the foreign jurisdiction.

Increase Withholdings on Bonuses. Under current law, employers may elect to withhold income tax on supplemental wages at a flat 27% rate. Most executives and employees receiving million dollar bonuses will ultimately be taxed at the rate of 38.6%. The proposal increases the withholding rate to the highest marginal tax rate (currently 38.6%) on supplemental pay of over $1 million.

Clarify Definition and Tax Treatment of Executive Loans. Whether a payment to an executive is a loan or compensation is a facts-and-circumstances test. The legislation would clarify that a payment would be considered as compensation rather than loan unless the arrangement met minimum standards (written debt instrument, established repayment periods, and adequate security). In addition, loans above $1 million would be required to have an interest rate equal to 3 percentage points higher than the applicable government published rate.

Miscellaneous Provisions in Senate Pension Bill

Faster Right to Divest For Those Age 55. The bill gives individuals the right to divest company stock contributed to a defined contribution account by the employer after three years of service. A transition rule permits companies to require the diversification of previously contributed stock over a three-year period. The amendment incorporated would permit immediate divestiture for employees who are nearing retirement (age 55 or older).

Teachers Benefit Plans. This provision addresses two issues: retirement plans for teachers that provide retention bonuses, and plans that provide early retirement incentives. Retention bonuses are caught in a dilemma which requires them to be valued for tax purposes when earned, even though it is impossible to calculate their value at that time because the retirement date is unknown. In the case of early retirement bonuses, most school districts pay teachers in different amounts based on age. Age is used because it is the basis for receiving different amounts from the state retirement system or social security. One appeals court has determined such a system violates the Age Discrimination in Employment Act (ADEA) even though the program is voluntary. This provision corrects both of these problems.

Exclude Broad-Based Stock Options from Wages. This provision provides for no taxation of the exercise of an incentive stock option (ISO) or under an employee stock purchase plan (ESPP), consistent with a recent Treasury announcement of an indefinite moratorium on requiring withholding of FICA and FUTA on ISOs and ESPPs.

Modify Holding Period Requirements for Stock Options for Executive Branch Appointees. This provision eliminates the holding period requirement for capital gains treatment with respect to ISOs and ESPPs for executive branch appointees and nominees who are required to divest these holdings. Current law requires them to hold the options for either two years after the granting of the option or one year from the exercise of the option to receive this treatment. The Office of Government Ethics has urged this change.

2001 Interest Rate Adjustment for Private Sector Defined Benefit Plans. The economic stimulus bill provided a short-term alternative to the traditional interest rate used for computation of contributions under private sector defined benefit plans after Treasury suspended issuance of certain 30-year debt instruments. The modification affected contributions related to 2002 and 2003. This provision would provide a more limited alternative computation for contributions related to 2001 (which are generally being made in 2002).

Automatic Rollovers of Certain Mandatory Distributions. This provision modifies a provision included in the pension section of EGTRRA to specify that amounts transferred from a qualified retirement plan to an IRA in an automatic rollover are no longer plan assets for ERISA purposes.

Chief Executive Officer Must Sign Federal Income Tax Return. This provision requires that the chief executive officer of a corporation must sign the federal income tax returns under penalties of perjury. Current law permits a signature by the president, vice-president, treasurer, assistant treasurer, chief accounting officer, or other officer duly authorized.

The Way Ahead

If they can ever get the left over spending bills out of the way, the legislative season in Washington will kick off with the President's State of the Union address on January 28, followed by the submission of the Administration's Budget to Congress on February 3.

John S. Stanton
Hogan & Hartson L.L.P.

Washington, D.C.
January 15, 2003

HOGAN & HARTSON LLP

SEC update

Status of Sarbanes-Oxley Act Initiatives Relating to Auditor Independence and Oversight

December 19, 2002

- Public Company Accounting Oversight Board
- Audit committee approval of non-audit services
- Audit partner rotation
- Auditor communications with audit committee
- "Cooling-off" period for employment of audit team members
- Improper influence on performance of audit
- Retention of audit records
- Auditor compensation

Although the SEC's implementation of the Sarbanes-Oxley Act is far from complete, we thought it would be useful for our clients and friends if we summarized the status of various provisions of the Act and related SEC rulemaking initiatives at the close of 2002. Our summary is divided into four major topics, each of which is addressed in a separate *SEC Update* we are issuing today. The topics are (1) auditor independence and oversight, (2) corporate governance, (3) management accountability, and (4) enhanced disclosure. Our summary does not cover all of the important aspects of the initiatives, many of which we discussed in detail in prior *SEC Updates*. We have included references to those publications where applicable in this summary. For ease of reference, we also have attached to this *SEC Update* a chart showing the status of each initiative it discusses.

Public Company Accounting Oversight Board

Sections 101-105 of the Act establish the framework for a new Public Company Accounting Oversight Board, or "PCAOB." All auditors involved in the audit of public company financial statements will be required to register with the PCAOB after the SEC declares that it is operational. The Act gives the PCAOB broad powers to oversee the accounting profession, including the

authority to inspect audit firms and impose a variety of sanctions for deficiencies. The PCAOB also has the authority to adopt generally accepted auditing standards, as well as standards for quality control and ethics. The SEC will have oversight and enforcement authority over the PCAOB. Foreign auditors would have to register with the PCAOB if they are involved in the audit of a public company "issuer" (as defined in the Act), although that requirement has drawn criticism from outside the United States. [*SEC Update* dated July 31, 2002]

Status: The PCAOB must be operational by April 26, 2003, and auditors must be registered within 180 days thereafter, which would be October 23, 2003, at the latest. The PCAOB has gotten off to a slow start because of funding concerns and the resignation of its initial chairman, although its members have stated that they expect to meet the April 26 deadline. One of the first actions of SEC Chairman Harvey Pitt's successor likely will be to fill the vacant PCAOB chairmanship.

Audit Committee Approval of Non-Audit Services

The SEC has proposed rules implementing Section 201 of the Act, which contains a list of non-audit services that, if provided by a company's outside auditor, would cause the auditor to no longer be considered independent. Most of the non-audit services listed in the Act already were prohibited under existing rules, but the SEC proposal would eliminate the exceptions and exemptions that currently allow auditors to provide some of those services in limited situations. Pursuant to Section 202 of the Act, the proposed rules would permit a company's auditor to provide other non-audit services if approved in advance by the company's audit committee (either directly or through established policies and procedures) and if the review satisfies four basic principles identified by the SEC. The rules contain a *de minimis* waiver for non-audit services inadvertently provided without appropriate authorization. The SEC proposal specifically addresses the permissibility of tax services and provides examples of the types of non-audit tax services that would be permitted, subject to committee pre-approval, and those that would not satisfy the basic principles. The rule proposal would require companies to disclose annually information about the nature of audit and non-audit services provided by the company's outside audit firm, the fees billed for those services and the procedures by which non-audit services were approved. This would expand the disclosure currently required in proxy statements, and also would apply to foreign private issuers and others that do not file proxy statements. [*SEC Update* dated December 6, 2002]

Status: The SEC published proposed rules on December 2, 2002 in Release No. 34-46934. Final rules must be adopted by January 26, 2003. The SEC indicated that it may consider delayed implementation of the disclosure requirements relating to fees billed by the company's outside auditor, which would mean the fee-related disclosures adopted in January likely would not be required in annual reports or proxy statements for companies with fiscal years ending December 31, 2002.

Audit Partner Rotation

The SEC proposes to implement Section 203 of the Act by requiring the lead partner and reviewing partner on an audit engagement to rotate off that engagement every five years and prohibiting them from rejoining that audit engagement until five years had passed. The SEC's proposed rules also would apply to other partners performing audit, review or attestation services for the company. The SEC would not require that all partners on an audit engagement be rotated at the same time, and audit firms likely will try to stagger the rotation of partners to ensure that there is continuity of expertise. This requirement could have a significant impact on companies that use smaller audit firms or operate in industries requiring specialized accounting expertise. [*SEC Update* dated December 6, 2002]

Status: The SEC published proposed rules on December 2, 2002 in Release No. 34-46934. Final rules must be adopted by January 26, 2003. The SEC indicated that it might consider a longer transition period for the audit partner rotation requirement.

Auditor Communications with Audit Committee

To implement Section 204 of the Act, the SEC has proposed to adopt rules requiring auditors to communicate with their clients' audit committees on a timely basis regarding (1) critical accounting policies and practices used by the company in the preparation of its financial statements, (2) alternative accounting treatments under generally accepted accounting principles ("GAAP") used by the company, including the ramifications of using the alternative treatments and the auditor's preferred treatment under GAAP, and (3) other material written communications between the audit firm and management. The covered communications should occur before any audit report is filed with the SEC in a current or periodic report, proxy statement or registration statement. [*SEC Update* dated December 2, 2002]

Status: The SEC published proposed rules on December 2, 2002 in Release No. 34-46934. Final rules must be adopted by January 26, 2003. The SEC indicated that it might consider delayed implementation of the auditor communication requirements.

"Cooling-Off" Period for Employment of Audit Team Members

The SEC proposes to implement Section 206 of the Act through proposed rules that would impose a one-year "cooling-off" period during which no member of the audit engagement team assigned to a company could be employed by that company in a "financial reporting oversight role." Examples of this type of position include a company's directors, CEO, CFO, COO, general counsel, chief accounting officer, controller, director of internal audit or financial reporting and treasurer. The term "audit engagement team" would include all partners, principals, shareholders and professional employees participating in an audit, review or attestation engagement, including those performing concurring or second partner reviews, and those consulted by a member of the audit engagement team on technical or industry-specific issues. [*SEC Update* dated December 6, 2002]

Status: The SEC published proposed rules on December 2, 2002 in Release No. 34-46934. Final rules must be adopted by January 26, 2003.

Improper Influence on Performance of Audit

To implement Section 303 of the Act, the SEC proposes to prohibit an officer or director of a public company (or anyone acting under his or her direction) from fraudulently influencing, coercing, manipulating or misleading an auditor engaged in auditing or reviewing the company's financial statements or issuing an attestation report to be filed with the SEC, if the person knew or reasonably should have known that the actions could render the financial statements materially misleading. [*SEC Update* dated October 25, 2002]

Status: The SEC published proposed rules on October 18, 2002 in Release No. 34-46685. Final rules must be adopted by April 26, 2003.

Retention of Audit Records

To implement Section 802 of the Act, the SEC proposes to require auditors to retain, for a period of five years, a broad range of records relating to the audit or review of a company's financial statements. The records to be retained would include not only the auditor's workpapers, but other documents and records (including electronic records) that (1) were created, sent or received in connection with the audit or review, and (2) contain conclusions, opinions, analyses or financial data

related to the audit or review. The covered materials would include not only those that support an auditor's conclusions about the financial statements, but also those that "cast doubt" on those conclusions. The Act directs the PCAOB to require retention of audit workpapers, as well as other materials supporting the auditor's conclusions, for a period of seven years, and the SEC has requested comment on whether its five-year proposal should be extended to seven years. [*SEC Update* dated December 6, 2002]

Status: The SEC published proposed rules on November 21, 2002, in Release No. 34-46869. Final rules must be adopted by January 26, 2003.

Auditor Compensation

Although not specifically required by the Act, the SEC proposes to amend its auditor independence rules to provide that an outside auditor is not independent if, at any time during the engagement period, any partner-level member of the audit engagement team earns compensation based on performing, or procuring an engagement to perform, non-audit services.

Status: The SEC published proposed rules on December 2, 2002 in Release No. 34-46934. This proposal is part of a package of proposed rules that must be adopted in final form by January 26, 2003, and likely will be finalized at the same time as the rest of that package.

For more information about the matters summarized in this *SEC Update*, or for copies of the previous *SEC Updates* referred to above, please contact the Hogan & Hartson L.L.P. attorney with whom you work, or any of the attorneys below who contributed to this *Update*, or who are part of our securities group listed at http://www.hhlaw.com/secattorneys/.

Peter J. Romeo (Co-Editor)
pjromeo@hhlaw.com

Sandra Folsom Kinsey
sfkinsey@hhlaw.com

Richard J. Parrino (Co-Editor)
rjparrino@hhlaw.com

www.hhlaw.com

Status of Sarbanes-Oxley Act Initiatives Relating to Auditor Independence and Oversight
(December 19, 2002)

	Sarbanes-Oxley Act of 2002	SEC Rulemaking	Effective?	Compliance Date
§§101 -108	**Public Company Accounting Oversight Board** Establishes independent, non-governmental public accounting oversight board (the "PCAOB") to oversee the audit of public companies subject to U.S. securities laws. Requires public accounting firms to register with the PCAOB in order to prepare, issue, or participate in the preparation or issuance of any audit report of an "issuer."	The PCAOB will adopt its own implementing rules, subject to SEC approval, prior to being declared operational by the SEC.	No	The PCAOB must be declared operational by the SEC within 270 days after enactment of the Act – by April 26, 2003. Accounting firms must register with the PCAOB within 180 days after the date SEC declares the PCAOB operational. If the PCAOB is operational on April 26, 2003, the latest possible registration date would be October 23, 2003.
§§201 -202	**Audit Committee Approval of Non-Audit Services** Prohibits registered public accounting firms from providing the specified non-audit services contemporaneously with audit services. Requires audit committee approval of all auditing and non-auditing services. Requires disclosure of non-audit services in periodic report. Contains *de minimis* exception for non-audit services.	SEC proposed rules on November 21, 2002 (Rel. No. 34-46934).	No	SEC is required to adopt final rules no later than January 26, 2003. May consider delayed implementation for new disclosure related to fees billed by audit firm.
§203	**Audit Partner Rotation** Requires registered accounting firms to rotate audit partner for issuers every five years.	SEC proposed rules on December 2, 2002 (Rel. No. 34-46934) to prohibit partners participating in an audit from providing services to the issuer for more than five consecutive years and for the five years following rotation off the engagement.	No	SEC is required to adopt final rules no later than January 26, 2003. May consider delayed implementation for audit partner rotation requirement.

	Sarbanes-Oxley Act of 2002	SEC Rulemaking	Effective?	Compliance Date
§204	**Auditor Communications with Audit Committee** Requires registered accounting firms to report to audit committee all (1) critical accounting policies and practices used, (2) alternative accounting treatments under GAAP used by the company, and (3) other material written communications with management.	SEC proposed rules on December 2, 2002 (Rel. No. 3-46934).	No	SEC is required to adopt final rules no later than January 26, 2003. May consider delayed implementation for auditor communication requirement.
§206	**"Cooling-Off" Period for Employment of Audit Team Members** Prohibits accounting firm from providing audit services if CEO, CFO, CAO, or person in equivalent position was employed by the accounting firm and participated in the audit within one year before initiation of the audit.	SEC proposed rules on December 2, 2002 (Rel. No. 34-46934).	No	SEC is required to adopt final rules no later than January 26, 2003.
§303	**Improper Influence on Performance of Audit** Prohibits any action by or at the direction of an officer or director fraudulently to influence, coerce, manipulate, or mislead any auditor engaged in the performance of an audit for the purpose of rendering financial statements materially misleading.	SEC proposed rules on October 18, 2002 (Rel. No. 34-46685)	No	SEC required to adopt final rules no later than April 26, 2003.
§802	**Retention of Audit Records** Requires SEC to adopt rules regarding retention of relevant corporate audit records.	SEC proposed rules on November 21, 2002 (Rel. No. 34-46869) to specify a broad range of materials that must be retained by auditors for a five-year period after the completion of an audit or review of the issuer's financial statements.	No	SEC required to adopt final rules no later than January 26, 2003.
		Auditor Compensation The SEC proposed rules on December 2, 2002 (Rel. No. 34-46934) providing that an outside auditor is not independent if, during engagement period, it earns any compensation for performing, or being engaged to perform, non-audit services.	No	Proposal is part of a package of rules that must be finalized no later than January 26, 2003.

HOGAN & HARTSON LLP

SEC update

Status of Sarbanes-Oxley Act Initiatives Relating to Enhanced Disclosure

December 19, 2002

- Financial reports to reflect material adjustments
- Disclosure of off-balance sheet transactions
- Pro forma ("non-GAAP") financial information
- Accelerated reporting under Section 16
- Internal control reports
- Form 8-K filing of earnings releases
- Accelerated filing of periodic reports
- Expanded list of Form 8-K disclosure items

Although the SEC's implementation of the Sarbanes-Oxley Act is far from complete, we thought it would be useful for our clients and friends if we summarized the status of various provisions of the Act and related SEC rulemaking initiatives at the close of 2002. Our summary is divided into four major topics, each of which is addressed in a separate *SEC Update* we are issuing today. The topics are (1) auditor independence and oversight, (2) corporate governance, (3) management accountability, and (4) enhanced disclosure. Our summary does not cover all of the important aspects of the initiatives, many of which we discussed in detail in prior *SEC Updates*. We have included references to those publications where applicable in this summary. For ease of reference, we also have attached to this *SEC Update* a chart showing the status of each initiative it discusses.

Financial Reports to Reflect Material Adjustments

Section 401 of the Act provides that financial statements included in SEC filings must reflect all material correcting adjustments that the filing company's auditor has identified as being in accordance with U.S. GAAP and SEC requirements. [*SEC Update* dated July 31, 2002]

Status: No SEC rulemaking is required or proposed. This provision of the Act became effective as of July 30, 2002.

Disclosure of Off-Balance Sheet Transactions

The SEC has proposed rules implementing Section 401(a) of the Act, which requires that public companies disclose, in their annual and quarterly reports, all material off-balance sheet transactions, arrangements, obligations and other relationships with unconsolidated entities and other persons. The SEC's proposed rules also would require that companies provide (1) a table showing their known contractual obligations and the amount of payments scheduled to come due at various intervals over the next five years and thereafter, and (2) a table or text showing the company's contingent liabilities and commitments and a schedule of amounts expected to expire at various intervals over the next five years and thereafter. [*SEC Update* dated November 14, 2002]

Status: The SEC published proposed rules on November 4, 2002 in Release No. 34-46767. Final rules must be adopted by January 26, 2003.

Pro Forma ("Non-GAAP") Financial Information

Section 401(b) of the Act requires that any pro forma financial information included in SEC filings be presented in a manner that does not contain a material misstatement or omission and is reconciled to GAAP. The SEC has proposed rules that would require a company that presents a "non-GAAP financial measure" in an SEC filing to include the most directly comparable GAAP financial measure, a reconciliation of differences between the two measures, and an explanation of the purpose for using the non-GAAP measure and the reasons why management believes it provides information useful to investors. Companies would be prohibited from using certain non-GAAP financial measures, such as those shown on a "per share" basis, in SEC filings. The SEC's rules also would require that if a company issues a press release or other publication containing non-GAAP financial measures, the non-GAAP information must be accompanied by and reconciled to the most directly comparable GAAP measure and may not contain material misstatements or omissions. [*SEC Update* dated November 8, 2002]

Status: The SEC published proposed rules on November 5, 2002 in Release No. 34-46768. Final rules must be adopted by January 26, 2003.

Accelerated Reporting Under Section 16

To implement Section 403 of the Act, the SEC has adopted rules requiring that directors, officers and ten percent shareholders file reports of their transactions in company equity securities within two business days, unless the transactions qualify for deferred reporting. Section 403 also requires that, within one year of the Act's passage, Section 16 reports be filed electronically, and be posted on corporate websites no later than the day following the date of filing. The SEC has indicated that it is "proceeding expeditiously" to meet the July 30, 2003 deadline for mandatory electronic filing and website disclosure, and has encouraged voluntary compliance in the interim. [*SEC Update* dated August 28, 2002]

Status: The SEC published final rules on August 27, 2002 in Release No. 34-46421. The SEC proposed rules to implement the electronic filing and website disclosure requirements of the Act at a meeting on December 18, 2002, but those proposed rules are not yet publicly available.

Internal Control Reports

The SEC proposes to implement Section 404 of the Act by requiring that a public company's annual report contain an internal control report, which would acknowledge management's responsibility for the company's internal control structure and financial reporting procedures and contain an assessment of the effectiveness of those controls and procedures. The internal control report would have to include an attestation report from the company's outside auditor that attests to, and reports on, management's evaluation of the internal controls and procedures for financial reporting. Quarterly reports would have to contain similar information (but without auditor attestation) for the period covered by the report, as well as disclosure of any significant changes in the controls and procedures during that period. The SEC included proposed changes to its CEO/CFO certification requirement (under Section 302 of the Act) to incorporate the required statements about internal controls and procedures. [*SEC Update* dated October 25, 2002]

Status: The SEC published proposed rules on October 22, 2002 in Release No. 34-46701. There is no statutory deadline for adoption of final rules, and the SEC has proposed that the requirements apply to companies with fiscal years ending on or after September 15, 2003, although voluntary compliance would be permitted in the interim. The SEC indicated that its proposed amendments to the CEO/CFO certification would not be effective until the first filing containing an internal control report.

Form 8-K Filing of Earnings Releases

Section 409 of the Act requires public companies to file promptly such information containing material changes in the financial condition or operations of the company as the SEC deems necessary or useful for investor protection or in the public interest. The SEC proposes to implement Section 409 by requiring public companies to file on Form 8-K, within two business days after issuance, any company earnings release or other announcement containing material nonpublic information regarding the company's financial condition or results of operations for a completed annual or quarterly period. The proposal would not compel companies to issue earnings releases, but would require that any releases they do issue be filed with the SEC. [*SEC Update* dated November 8, 2002]

Status: The SEC published proposed rules on November 5, 2002 in Release No. 34-46768. The Act does not contain a deadline for adoption of final rules.

Accelerated Filing of Periodic Reports

Although not specifically mandated by the Act, the SEC has adopted rules that accelerate the filing dates for annual reports on Form 10-K and quarterly reports on Form 10-Q filed by companies with a common equity public float of at least $75 million and with a 12-month SEC reporting history. These "accelerated filers" must comply with shorter filing deadlines that would be phased in over three years. The first changes (for accelerated filing of annual reports) would take effect for fiscal years ending on or after December 15, 2003. When fully phased in, the new requirements would result in filing deadlines of 60 days after the end of the fiscal year for annual reports and 35 days after the end of the fiscal quarter for quarterly reports. Beginning with annual reports for fiscal years ending on or after December 15, 2002, the SEC rules also require an accelerated filer to disclose its website

address, whether or not its periodic reports filed during the period covered by the report (or since November 15, 2002 for the first annual report) have been available on its website as soon as reasonably practical after the reports were filed and, if not, the reason why. [*SEC Update* dated September 9, 2002]

Status: The SEC published its final rules on September 5, 2002, in Release No. 34-46464.

Expanded List of Form 8-K Disclosure Items

In an initiative that pre-dated the Act, the SEC proposed to (1) expand the list of reportable items on Form 8-K, and (2) accelerate the filing deadline for Form 8-K reports to two business days following the event that triggered the filing. The proposal would add 13 new reportable items and amended several existing items.

Status: The SEC published its proposed rules on June 17, 2002, in Release No. 34-46084. There is no deadline for adoption of final rules.

For more information about the matters summarized in this *SEC Update*, or for copies of the previous *SEC Updates* referred to above, please contact the Hogan & Hartson L.L.P. attorney with whom you work, or any of the attorneys below who contributed to this *Update*, or who are part of our securities group listed at http://www.hhlaw.com/secattorneys/.

Peter J. Romeo (Co-Editor)
pjromeo@hhlaw.com

Sandra Folsom Kinsey
sfkinsey@hhlaw.com

Richard J. Parrino (Co-Editor)
rjparrino@hhlaw.com

www.hhlaw.com

Status of Sarbanes-Oxley Act Initiatives Relating to Enhanced Disclosure
(December 19, 2002)

	Sarbanes-Oxley Act of 2002	SEC Rulemaking	Effective?	Compliance Date
§401	**Financial Reports to Reflect Material Adjustments** Requires financial reports to reflect all material correcting adjustments that have been identified by auditors in accordance with GAAP and SEC rules.	No SEC rulemaking is required or proposed.	Yes	Effective as of July 30, 2002.
	Disclosure of off-balance sheet transactions Requires disclosure of all material off-balance sheet transactions in annual and quarterly reports.	SEC proposed rules on November 4, 2002 (Rel. No. 34-46767), which also require disclosure of contractual obligations and contingent liabilities and commitments.	No	SEC required to adopt final rules no later than January 26, 2003.
	Pro Forma ("Non-GAAP") Financial Information Requires pro forma financial information included in SEC reports or in any public disclosure or press release to be presented in a manner that does not contain a material misstatement or omission and to be reconciled with the most directly comparable financial measure under GAAP.	SEC proposed rules on November 5, 2002 (Rel. No. 34-46768), which also prohibit the use of certain non-GAAP measures in SEC filings.	No	SEC required to adopt final rules no later than January 26, 2003.

	Sarbanes-Oxley Act of 2002	SEC Rulemaking	Effective?	Compliance Date
§403	**Accelerated Reporting Under Section 16** Requires insiders to report transactions in company stock within two business days after transaction. Requires electronic filing of beneficial ownership reports and website posting of such reports by SEC and issuers.	SEC adopted rules on August 27, 2002 (Rel. No. 34-46421) requiring two-day filing. SEC proposed rules (not yet publicly available) relating to electronic filing/website posting on December 18, 2002.	Yes No	Effective as of August 29, 2002. SEC must issue final rules no later than July 30, 2003.
§404	**Internal Control Report** Requires annual reports to contain management's report on effectiveness of company's internal controls and procedures for financial reporting and the auditor's attestation of that report.	SEC proposed rules on October 22, 2002 (Rel. No. 34-46701), which also require similar information (but no attestation report) in quarterly reports.	No	No deadline for final rules. SEC proposes effectiveness for fiscal years ending on or after September 15, 2003.
§409	**Form 8-K Filing of Earnings Releases** Requires disclosure of material changes in financial condition or operations on a "rapid and current" basis.	SEC proposed rules on November 5, 2002 (Rel. No. 34-46768) , which require registrants to file earnings releases and similar announcements on Form 8-K within two business days of publication.	No	SEC required to adopt final rules no later than January 26, 2003.

	Sarbanes-Oxley Act of 2002	SEC Rulemaking	Effective?	Compliance Date
		Accelerated Filing of Periodic Reports The SEC adopted rules on September 5, 2002 (Rel. No. 34-46464) to phase in shorter deadlines for "accelerated filers" to file quarterly and annual reports. Accelerated filers also must disclose in their annual reports where investors can obtain access to their filings.	Yes Yes	The phase-in of shorter filing deadlines begins with annual reports for companies with fiscal years ending on or after December 15, 2003. Effective for annual reports for fiscal years ended on or after December 15, 2002.
		Expanded List of Form 8-K Disclosure Items The SEC proposed on June 17, 2002 (Rel. No. 34-46084) to add 13 new reportable items to Form 8-K and amend several existing items.	No	No deadline for adoption of final rules.

SEC update

Status of Sarbanes-Oxley Act Initiatives Relating to Management Accountability

December 19, 2002

- CEO/CFO certification of periodic reports (§302)
- CEO/CFO certification under criminal code (§906)
- CEO/CFO disgorgement after restatement of financials
- Prohibition on service as director or officer
- Prohibition on stock trading during pension "blackout"
- Prohibition on loans to insiders
- "Whistleblower" protections
- Expanded penalties for wrongdoing

Although the SEC's implementation of the Sarbanes-Oxley Act is far from complete, we thought it would be useful for our clients and friends if we summarized the status of various provisions of the Act and related SEC rulemaking initiatives at the close of 2002. Our summary is divided into four major topics, each of which is addressed in a separate *SEC Update* we are issuing today. The topics are (1) auditor independence and oversight, (2) corporate governance, (3) management accountability, and (4) enhanced disclosure. Our summary does not cover all of the important aspects of the initiatives, many of which we discussed in detail in prior *SEC Updates*. We have included references to those publications where applicable in this summary. For ease of reference, we also have attached to this *SEC Update* a chart showing the status of each initiative it discusses.

CEO/CFO Certification of Periodic Reports (§302)

The SEC has adopted rules to implement Section 302 of the Act, which requires a public company's CEO and CFO each to certify, with respect to every quarterly and annual report, that to the officer's knowledge there are no material misstatements or omissions in the report and the report fairly

presents the company's financial condition, and to certify the quality of the company's internal controls and procedures that are intended to assure the quality of its financial reporting. The SEC subsequently proposed amendments to expand the scope of the certification and change the date as of which it speaks. [*SEC Updates* dated August 30, 2002 and October 25, 2002]

Status: The SEC published final rules on August 29, 2002 in Release No. 34-46427, which were effective for reports on periods ended after August 29, 2002. The SEC published proposed amendments to the wording of the certification on October 22, 2002 in Release No. 34-46701. There is no deadline for adoption of these amendments, but the SEC has indicated that the amended form of certificate would not be effective until the first annual report in which the company includes an "internal control report" as required by Section 404 of the Act, which is proposed to apply only to companies with fiscal years ending on or after September 15, 2003.

CEO/CFO Certification Under Criminal Code (§906)

Section 906 of the Act requires that each periodic report filed with the SEC be accompanied by a statement of the company's CEO and CFO that the report "fully complies" with the requirements of the Securities Exchange Act of 1934 and that the information in the report fairly presents, in all material respects, the company's financial condition and results of operations. This certification requirement, unlike the one required by Section 302 of the Act (described above), is not limited to the officer's knowledge, and the "fully complies" statement is not limited to material compliance. The Act imposes criminal penalties if an officer knowingly or willfully makes a false certification. Since this provision is part of the criminal code, the SEC considers it to be within the Justice Department's jurisdiction, and has declined to provide interpretive guidance. [*SEC Update* dated July 31, 2002]

Status: No SEC rulemaking is required or proposed. This provision of the Act became effective as of July 30, 2002. The staffs of the SEC and the Justice Department are exploring informally the possibility of combining the certification requirements of Sections 302 and 906 of the Act.

CEO/CFO Disgorgement After Restatement of Financials

Section 304 of the Act requires that if a company's financial statements are restated because of misconduct, the CEO and CFO must reimburse the company for any bonuses or other incentive compensation and any trading profits derived in the 12-month period following first publication of the financial statements. The reference to "misconduct" is not limited to misconduct by the CEO or CFO. The SEC has authority to issue exemptions as it deems necessary and appropriate. [*SEC Update* dated July 31, 2002]

Status: No SEC rulemaking is required or proposed. This provision of the Act became effective as of July 30, 2002.

Prohibition on Service as Director or Officer

Sections 305 and 1105 of the Act give the SEC direct authority to prohibit a person who has violated the antifraud provisions of the federal securities laws from serving as an officer or director of a public company if that person has demonstrated unfitness to serve in such a capacity. Before enactment of these provisions, the SEC had to seek a court order to bar someone from serving as a director or officer and had to show that the person had demonstrated "substantial unfitness." [*SEC Update* dated July 31, 2002]

Status: No SEC rulemaking is required or proposed. This provision of the Act became effective as of July 30, 2002.

Prohibition on Stock Trading During Pension "Blackout"

To implement Section 306 of the Act, the SEC has proposed to adopt rules prohibiting the directors and executive officers of a public company from acquiring or disposing, during any "blackout period," of any equity security of the company that they acquired as incentive compensation or as the result of a related party transaction. A blackout period is one in which at least half the participants in the company's individual account retirement plan are unable to acquire or dispose of their plan securities or interests. This definition of the term has been tailored to reduce the proposal's impact on non-U.S. companies that have relatively few U.S. employees. [*SEC Update* dated November 14, 2002]

Status: The SEC published proposed rules on November 6, 2002 in Release No. 34-46778. Final rules must be adopted by January 26, 2003.

Prohibition on Loans to Insiders

Section 402 of the Act prohibits public companies from directly or indirectly extending credit, or arranging for the extension of credit, in the form of a personal loan to the company's directors or executive officers. Certain types of consumer loans made by companies in the business of providing consumer credit are excluded, as are loans by U.S. banks and savings associations insured by the FDIC. This provision of the Act is broadly worded and could be read to cover many arrangements not normally thought of as loans. The SEC has not indicated whether it plans to provide any guidance on the application of this provision. [*SEC Update* dated July 31, 2002]

Status: No SEC rulemaking is required or proposed. This provision of the Act became effective as of July 30, 2002. Loans existing on that date were "grandfathered" unless they are later renewed or materially modified.

"Whistleblower" Protections

Section 806 of the Act protects a public company's employees, contractors, subcontractors and agents from employment termination or other retaliatory action if they provide evidence relating to what they reasonably believe is corporate fraud or if they participate in a fraud-related investigation or proceeding. Section 1107 of the Act imposes criminal penalties for retaliatory action against a whistleblower. [*SEC Update* dated July 31, 2002]

Status: No SEC rulemaking is required or proposed. These provisions of the Act became effective as of July 30, 2002.

Expanded Penalties for Wrongdoing

Various sections of the Act broaden the criminal sanctions available for securities law and related violations by (1) increasing the maximum penalties for pre-existing crimes; (2) creating new criminal offences, particularly for obstructing justice or impeding an investigation by destroying documents or tampering with records; and (3) lengthening federal sentencing guidelines for financial fraud and for offenses by corporations and other entities. In addition to other enforcement tools, the Act gives the SEC authority to freeze assets in connection with an investigation. It also extends the statute of limitations for civil actions alleging securities fraud to the earlier of two years after discovery of the violation (one year under prior law) or five years after its occurrence (from three years under prior law). [*SEC Update* dated July 31, 2002]

Status: No SEC rulemaking is required or proposed. These provisions of the Act became effective as of July 30, 2002, although the U.S. Sentencing Commission was given 180 days to review and amend its sentencing guidelines.

For more information about the matters summarized in this *SEC Update,* or for copies of the previous *SEC Updates* referred to above, please contact the Hogan & Hartson L.L.P. attorney with whom you work, or any of the attorneys below who contributed to this *Update*, or who are part of our securities group listed at http://www.hhlaw.com/secattorneys/.

Peter J. Romeo (Co-Editor)
pjromeo@hhlaw.com

Sandra Folsom Kinsey
sfkinsey@hhlaw.com

Richard J. Parrino (Co-Editor)
rjparrino@hhlaw.com

www.hhlaw.com

Status of Sarbanes-Oxley Act Initiatives Relating to Management Accountability
(December 19, 2002)

	Sarbanes-Oxley Act of 2002	SEC Rulemaking	Effective?	Compliance Date
§302	**CEO/CFO Certification of Periodic Reports (§302)** Requires CEO/CFO certifications of contents of annual and quarterly reports and status of corporate controls.	SEC adopted final rules on August 29, 2002 (Rel. No. 34-46427) to require the certification specified in the Act and to require companies to maintain disclosure controls and procedures. SEC proposed amendments to the certification requirement on October 22, 2002 (Rel. No. 34-46701).	Yes No	Effective for all annual and quarterly reports for periods ended after August 29, 2002. Proposed to be effective with first annual report filed for a fiscal year ending on or after September 15, 2003.
§906	**CEO/CFO Certifications Under Criminal Code (§906)** Requires each periodic report be accompanied by CEO/CFO certification that report fully compliance with Securities Exchange Act and fairly presents, in all material respects, the company's financial condition and results.	No SEC rulemaking required or proposed.	Yes	No SEC rulemaking required or proposed.
§304	**CEO/CFO Disgorgement After Restatement of Financials** Requires CEO/CFO to disgorge certain compensation and trading profits if, as a result of misconduct, a company is required to restate its financial statements.	No SEC rulemaking required or proposed.	Yes	Effective as of July 30, 2002.
§305	**Prohibition on Service as Director or Officer** Gives SEC direct authority to bar officer or director service with a public company after a securities fraud violation.	No SEC rulemaking required or proposed.	Yes	Effective as of July 30, 2002.

	Sarbanes-Oxley Act of 2002	SEC Rulemaking	Effective?	Compliance Date
§306	**Prohibition on Stock Trading During Pension "Blackout"** Prohibits directors and officers from purchasing, selling, or transferring any equity security of the company during pension fund blackout period if securities were acquired as compensation or in a related party transaction. Requires disgorgement of profits received from such trading.	SEC proposed rules on November 6, 2002 (Rel No. 34-46778).	No	SEC required to adopt final rules no later than January 26, 2003.
§402	**Prohibition on Loans to Insiders** Prohibits a company from directly or indirectly extending (or arranging for the extension of) credit in the form of personal loans to directors or executive officers. Grandfathers loans outstanding on July 30, 2002, unless renewed or materially modified	No SEC rulemaking required or proposed.	Yes	Effective as of July 30, 2002.
§§806 and 1107	**"Whistleblower" Protections** Prohibits companies from employment terminations or other retaliation against employees who provide evidence relating to corporate fraud or who assist in a fraud-related investigation. Section 11057 imposes criminal penalties for retaliation.	No SEC rulemaking required or proposed.	Yes	Effective as of July 30, 2002.
Vari-ous §§	**Expanded Penalties for Wrongdoing** Increases penalties for existing crimes, creates new crimes, lengthens sentencing guidelines, expands SEC staff enforcement power, and extends the statute of limitations for civil fraud actions.	No SEC rulemaking required or proposed.	Yes	Effective as of July 30, 2002. U.S. Sentencing Commission has 180 days to review and amend sentencing guidelines.